



Michigan League FOR Human Services

## TESTIMONY ON REPEAL OF SERVICES TAX

**House Tax Policy Committee**

**November 7, 2007**

**Lansing, Michigan**

I am Ann Marston, president and CEO of the Michigan League for Human Services, a nonprofit policy and advocacy organization concerned about improving the lives of low-income citizens. We appreciate the opportunity to give our written testimony at a public hearing on this important issue.

While there is much to criticize about the eleventh-hour passage of the expansion of the state sales tax to services, the Michigan League for Human Services urges you to consider why a sales tax on services absolutely must be a part of a modern tax structure.

***Why tax services? Because this is the growing part of our economy.***

Without a tax that captures growth, we simply cannot keep up with inflationary costs and are forced to make real program cuts year after year after year. To understand this dynamic, you only have to look at schools across our state where several years of flat funding or small increases have resulted in layoffs, rising classroom sizes and fewer program offerings.

Sales taxes in Michigan were left off of services by historic accident. When sales taxes were first created in the 1930s, services were just a small part of consumer spending, with goods making up the bulk of spending. Since then, however, services have skyrocketed. In 2003, services made up 60 percent of personal consumption.

Prior to the recent expansion, Michigan taxed only 26 services, primarily utilities, out of 164 types of services, according to the Federation of Tax Administrators.

Services are the largest single exclusion in the state's sales tax base. The estimated loss of revenue in FY 2001 was \$4.6 billion, jumping to \$8.6 billion in FY 2005. And it's only going to get bigger.

Expanding the tax base to include services creates short-term gains by creating revenue without raising tax rates. Long-term, as consumers spend more on services, states taxing those services will see faster growth in sales tax revenue.

Broadening the sales tax base also brings more stability to state revenues.

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While sales taxes are generally considered regressive – taking a bigger percent of income from low-income taxpayers than high-income taxpayers – expanding them to services actually makes them fairer since wealthy taxpayers disproportionately consume more services. Also, Michigan already exempts food and prescription drugs from sales tax.

As the League has said in the past, business-to-business taxes should not be a part of this expansion. Economists generally agree that taxing goods and services consumed by the individual is unlikely to alter consumption. But taxing business services, such as legal or accounting services, will result in higher consumer prices. Depending on how many levels were taxed, business-to-business taxes may alter consumption.

Finally, I must reiterate our stance that we cannot make more cuts in state programs. Michigan workers are finding it harder and harder to find jobs that cover basic needs. As a result, more families are turning to tax-dollar supported social services to feed, house and clothe their children. More families need help with health care. A national report released last week found Michigan losing employer-sponsored health care at an alarming rate. More families where parents work full time are finding themselves living in poverty. Support services to fill in the gaps are critical and we must be able to pay for those programs.

It is untenable to repeal this new tax without a revenue replacement. We simply cannot cut our way out of this situation without real harm to vulnerable people who live in your districts.

Even the tax that has brought us to this hearing – the new sales tax expansion to selected services, coupled with the income tax increase – is not enough to prevent future deficits. State fiscal analysts and independent analysts are already predicting a deficit next year.

While it sounds as if on one hand we're supporting sales tax on services, and on the other hand criticizing them, it is simply that without taxes on services, the future structural deficit will be much, much worse.

Sales tax on services must be a part of a modern tax structure. When properly done, it is good tax policy. By taxing services, sales taxes are less regressive and more responsive to economic growth. Finally, a properly crafted sales tax on services could go a long way to fixing our structural deficit.